**BEFORE THE WASHINGTON**

**UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of NORTHWEST NATURAL GAS COMPANYApplication for Approval of Corporate Reorganization to Create a Holding Company.  | DOCKET NO. UG-\_\_\_\_\_\_\_\_APPLICATION OF NORTHWEST NATURAL GAS COMPANY |

# INTRODUCTION

1. In accordance with Chapter 80.12 of the RCW and WAC 480-143-100 et. seq., Northwest Natural Gas Company (“NW Natural” or “Company”) files this application (“Application”) requesting approval from the Washington Utilities and Transportation Commission (“Commission”) to implement a corporate reorganization that will result in a holding company structure (“Reorganization”). Through the Reorganization, NW Natural will become a wholly owned subsidiary of a newly formed holding company (“HoldCo”). Each current subsidiary of NW Natural will be a wholly owned subsidiary, directly or indirectly, of HoldCo.
2. NW Natural believes that a holding company structure will allow the Company to better respond to the changing business environment of the natural gas industry, while further insulating NW Natural’s public utility from non-public-utility businesses.[[1]](#footnote-2) In fact, the holding company structure is a well-established form of organization for companies engaged in multiple lines of business; NW Natural is one of two independent local distribution companies nationwide that is *not* currently organized under a holding company structure. NW Natural’s Reorganization is in the best interests of customers and shareholders and is consistent with the public interest. Importantly, the Reorganization will provide benefits to NW Natural’s customers without altering the Commission’s ability to effectively regulate the Company’s utility operations and will not change customer rates or the Company’s provision of safe, reliable natural gas service.
3. The Reorganization will benefit customers by further reinforcing the legal and financial separation between NW Natural’s regulated utility operations and those conducted through other subsidiaries. Although NW Natural already maintains separation between its regulated and other affiliated operations, the additional safeguards and legal construct will help ensure that the financial results of the other affiliates will not harm the utility’s capital structure, credit ratings, or cost of capital. The Reorganization will also separate the utility side of the business from any financial arrangements between the holding company and other affiliates to better insulate utility assets and reduce any risk that such assets could be reached by creditors of the non-regulated affiliates.
4. In conjunction with its Reorganization proposal, the Company offers numerous commitments that are designed to mitigate any potential risks associated with the Reorganization, and which the Company proposes the Commission adopt as conditions to approval of the Application. These commitments include effective utility ring-fencing provisions to ensure that the holding company provides an overall benefit to the utility. The Company’s proposed commitments also ensure that the Reorganization will not compromise the Commission’s ability to regulate NW Natural in the public interest or result in cross-subsidization between the utility and unregulated entities, and that customers will not bear any costs associated with the Reorganization. Thus, the benefits of the Reorganization, together with the commitments, ensure that the transaction will result in net benefits to customers, as required by RCW 80.12.020(1).
5. Finally, the Reorganization will not in any way affect the financial, technical, or managerial abilities of NW Natural to continue to provide high-quality, reliable utility service. Indeed, from an operational perspective, the Reorganization will have no impact on the day-to-day operations of the utility. The Reorganization will not affect the Company’s rates or charges. After the Reorganization, the Company will continue to provide the same safe and reliable natural gas service to its customers that it has for over one hundred years.

# DISCUSSION

1. **General Information.**
2. NW Natural is a utility that is subject to the Commission’s jurisdiction under RCW 80.04.010. NW Natural’s principal business office is located at 220 NW Second Avenue, Portland, Oregon 97209. Communications regarding this Application should be addressed to the following:

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## Proposed Reorganization.

### **NW Natural’s Current Corporate Structure.**

1. NW Natural is currently a publicly held operating company. The Company’s utility operations are all conducted at the operating company level, while a number of wholly and partially owned subsidiaries conduct the Company’s other businesses.[[2]](#footnote-3) The following figure shows NW Natural’s existing structure:

Exhibit A to this Application contains a description of each of the subsidiaries shown above.

### **The Proposed Reorganization.**

1. If approved, the Reorganization will be accomplished through the following four steps.
2. *First*, two new companies will be incorporated: HoldCo will be formed as a subsidiary of NW Natural, and a merger subsidiary (“Merger Sub”) will be formed as a subsidiary of HoldCo.[[3]](#footnote-4) Merger Sub will be utilized for the sole purpose of effectuating the transaction.
3. *Second*, once HoldCo and Merger Sub are formed, NW Natural will contribute to HoldCo all of its stock and its interest in its current subsidiaries.
4. *Third*, Merger Sub will be merged into NW Natural, with NW Natural as the surviving company. At the end of this step, Merger Sub will no longer exist.
5. *Fourth,* by terms of the merger and operation of law, eachshare of NW Natural will convert into one share of HoldCo (with identical rights as NW Natural shares). HoldCo’s shares will be registered with the Securities and Exchange Commission (“SEC”), and once the merger, including this share conversion occurs, NW Natural will become a wholly owned subsidiary of HoldCo.[[4]](#footnote-5) A draft copy of the Agreement and Plan of Merger between NW Natural and HoldCo is attached to this Application as Exhibit B.
6. The following figure shows how the Reorganization will be accomplished:



1. After the Reorganization, HoldCo will be owned by public shareholders, and it will hold the stock of one or more operating companies, including the utility, NW Natural. All NW Natural operations, and any current or future affiliates, will be at the subsidiary level. NW Natural will continue to operate as a regulated utility under the jurisdiction of the Commission.

 The following figure shows the corporate structure after the Reorganization:

1. Importantly, NW Natural will not transfer any of its utility assets or property to HoldCo or to any other affiliate. In addition, the Reorganization will not affect any of the rights or preferences of shares currently held in NW Natural. Each share will represent the same relative interest in HoldCo as it currently does in NW Natural. As such, the overall shareholder ownership base in HoldCo immediately following the Reorganization will be identical to the shareholder base in NW Natural immediately prior to the Reorganization.

### **Corporate Governance after Reorganization.**

1. The corporate governance of NW Natural will remain unchanged after the Reorganization. All current NW Natural officers will remain NW Natural officers. Similarly, the Board of Directors of NW Natural will continue to serve in its same capacity. Members of the NW Natural Board of Directors will also serve on the HoldCo Board of Directors, but the two boards will exercise separate and independent functions and duties.

## 4. Reorganization’s Effect on Company Operations.

1. From the perspective of NW Natural’s utility customers, the Reorganization will be seamless and largely imperceptible. Rates will not change as a result of this reorganization. Moreover, day-to-day operations will remain the same; the Company will provide the same high-quality reliable service as before. After the Reorganization, NW Natural would continue to be subject to the same regulatory jurisdiction of the Commission as to rates, service, accounting and other general matters of utility operations.
2. **Applicable Legal Standard.**
3. Under RCW Chapter 80.12, NW Natural must obtain Commission approval prior to selling, leasing, assigning, or otherwise disposing of any of its property that is necessary or useful in the performance of its duties to the public.[[5]](#footnote-6) The Commission has previously applied this provision to the transfer of utility stock resulting from the formation of a holding company.[[6]](#footnote-7)
4. RCW 80.12.020(1) provides that the Commission “shall not approve any transaction under this section that would result in a person, directly or indirectly, acquiring a controlling interest in a gas or electrical company without a finding that the transaction would provide a net benefit to the customers of the company.” Similarly, the Commission’s rules state that an application under RCW Chapter 80.12 will be approved only if it is consistent with the public interest.[[7]](#footnote-8)
5. To ensure that customers benefit from a transaction, the Commission typically imposes conditions designed to mitigate customers’ exposure to potential risks.[[8]](#footnote-9) Here, the Reorganization itself will provide direct customer benefits without direct customer costs. In addition, the Company proposes certain commitments that will mitigate customer risk and offer additional benefits, ensuring that the Reorganization satisfies the net benefits requirement.

**1. The Reorganization, Together with the Proposed Conditions, Will Result in Net Benefits to NW Natural Customers and No Harm to the Public.**

1. The Reorganization will not result in changes to the Company’s regulated utility operations and will not impose any costs on customers. The Company nevertheless recognizes that corporate reorganizations can create customer risk and that, as mentioned above, the Commission typically imposes conditions to mitigate these risks and to ensure customer benefits. Thus, to satisfy the net benefits standard and ensure that the Reorganization is consistent with the public interest, the Company offers the following commitments.

**Access to Records**

1. NW Natural will provide the Commission with access to all books of account as well as all documents, data, and records of NW Natural, HoldCo, and its affiliated interests, which pertain to transactions between NW Natural and its affiliated interests or which are otherwise relevant to the business of NW Natural.
2. NW Natural, HoldCo, and any affiliates will make their employees, officers, directors and agents available to testify before the Commission to provide information relevant to matters within the jurisdiction of the Commission.
3. NW Natural and HoldCo will provide the Commission access to corporate minutes, including Board of Director’s minutes and all committee minutes with relevant information regarding NW Natural.
4. Nothing in these Reorganization commitments will be interpreted as a waiver of NW Natural’s or HoldCo’s rights to request confidential treatment for information that is the subject of any of these commitments.

**Cost Allocation**

1. Any allocation of costs, corporate and affiliate investments, expenses, or overheads between NW Natural and HoldCo or an affiliate of HoldCo will comply with the following principles:
	1. For services rendered to NW Natural or each cost category subject to allocation to NW Natural by HoldCo or any of its affiliates, NW Natural must be able to demonstrate that such service or cost category is necessary to NW Natural for the reasonable performance of its regulated operations, is not duplicative of services already being performed within NW Natural, and is reasonable and prudent.
	2. Cost allocations to NW Natural will be directly charged whenever possible, and shared or indirect costs will be allocated based upon the primary cost-driving factors.
	3. HoldCo and its subsidiaries will have in place an accounting system adequate to support the allocation and assignment of costs of executives and other relevant personnel to or from NW Natural.
	4. All costs subject to allocation will be auditable, such that they can be specifically identified, particularly with respect to their origin.
	5. Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for approval. The Company’s Master Services Agreement will be updated to include the corporate and affiliate cost allocation methodologies between HoldCo, NW Natural and their affiliates. The Master Services Agreement will be filed with the Commission for review, no later than 90 days after close of the transaction. Approval of the Master Service Agreement will be requested, but approval for ratemaking purposes will not be requested in such filing. Amendments to the Master Service Agreement will also be filed with the Commission.
	6. NW Natural and HoldCo commit to using asymmetrical pricing for any transactions between NW Natural and HoldCo or between NW Natural and any of HoldCo’s subsidiaries (*i.e.* goods or services priced at higher of cost or market when purchased from or provided by NW Natural, and priced at lower of cost or market when sold to or provided to NW Natural).
2. The Commission may audit the accounting records of HoldCo and its subsidiaries or affiliates that are the bases for charges to NW Natural to determine the reasonableness of allocation factors used by HoldCo to assign costs to NW Natural and amounts subject to allocation or direct charges. HoldCo will cooperate fully with such Commission audits.
3. No organizational and start-up costs associated with the creation of HoldCo will be allocated to NW Natural’s customers.

**Financial Commitments**

1. NW Natural will maintain its own books and records, separate from the books and records of HoldCo. NW Natural’s financial books and records and state and federal regulatory filings and documents will continue to be available to the Commission, upon request.
2. NW Natural will maintain separate debt, and if outstanding, preferred stock ratings. NW Natural will maintain its own corporate credit rating, as well as ratings for each long-term debt (and preferred stock (if any)) issuance that would otherwise be rated.
3. NW Natural shall not be permitted to declare or make any distributions unless, on the date of such distribution, the NW Natural common equity ratio after giving effect to such distribution is not less than 40 percent of total NW Natural capital, except to the extent a lower equity ratio is established for ratemaking purposes by the Commission, or unless otherwise ordered by the Commission.
4. NW Natural and HoldCo commit that NW Natural will not make any dividends to HoldCo if NW Natural’s secured debt rating falls below investment grade, or unless otherwise ordered by the Commission.
5. The assets of NW Natural and HoldCo and its subsidiaries or affiliates will be accounted for separately.

**Holding Company Subsidiaries/Affiliated Interests**

1. NW Natural and HoldCo will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.
2. NW Natural and HoldCo will enter into an agreement that incorporates the ring-fencing provisions set forth herein. This agreement will be binding on NW Natural and HoldCo, and their respective Boards of Directors. This agreement will be filed with the Commission within 90 days of the transaction’s closing. NW Natural and HoldCo commit that no amendments, revisions, or modifications will be made to this agreement or any ring-fencing provisions without prior Commission approval.

**Non-Consolidation Opinion**

1. Within 60 days of the formation of HoldCo, NW Natural will provide a non-consolidation opinion to the Commission which concludes that the ring-fencing provisions and other provisions of the Reorganization are sufficient such that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of NW Natural with those of HoldCo, its affiliates or subsidiaries. In the event that NW Natural is unable, for any reason, to obtain such an opinion, it will consult with parties to this docket, and the Commission regarding this topic.
2. As discussed in more detail below, the direct benefits of the Reorganization, together with risk mitigation and additional benefits offered by the proposed conditions, will ensure that NW Natural’s customers receive net benefits and that the general public will not be harmed.

### **2. The Proposed Commitments Will Effectively Mitigate any Potential Harms of the Holding Company Structure and Provide Comprehensive Protections to Customers.**

1. Together, these commitments help ensure that the Reorganization will not harm NW Natural’s customers. *First*, the commitments ensure that the Commission will continue to have access to all relevant records necessary to fulfill its obligation to regulate NW Natural in the public interest. The fact that NW Natural will be a subsidiary of a holding company should not, in any way, impede the Commission’s access to necessary information.
2. *Second*, the Company’s proposed ring-fencing provisions help ensure that NW Natural’s utility operations will not be adversely impacted by operations at the holding company level or operations associated with another holding company subsidiary. Most importantly, the Company commits that it will not make any dividend payments to HoldCo if doing so reduces its equity ratio below a reasonable level such that the credit rating of NW Natural would be threatened. This commitment ensures that the holding company structure will not compromise NW Natural’s financial integrity by creating an overly leveraged balance sheet.
3. In addition, the Company’s ring-fencing commitments ensure that both the utility and HoldCo will maintain separate accounting books, separate assets, and separate credit ratings, and will further insulate the utility from creditors of other subsidiaries. These steps will help ensure that no harm will result from the Reorganization and will provide benefits to NW Natural’s customers that do not exist today.
4. *Third*, the commitments ensure that costs will be properly allocated among the utility, HoldCo and its subsidiaries so that rates accurately reflect only those costs incurred to serve customers. The Company commits that no costs associated with the Reorganization or any future holding company costs will be recovered in rates.
5. *Fourth*, the commitments ensure that the holding company structure will not allow cross subsidization between NW Natural and HoldCo or its other affiliates or subsidiaries.
6. Taken together, the Company’s comprehensive commitments will ensure that the Reorganization will not harm customers and will, in fact, benefit them.

**3. The Reorganization Will Provide Direct Benefits to NW Natural’s Utility Customers.**

1. The Reorganization, together with the proposed conditions, will provide direct benefits to NW Natural’s customers. The Reorganization will strengthen the existing separation between the utility and non-regulated affiliates by ensuring legal and financial separation of NW Natural from HoldCo and other affiliates, and providing protections for the financial strength of NW Natural. The non-consolidation opinion the Company has proposed to provide as a condition of approval will provide customers with an assurance of this separation that they do not have today. This enhanced separation will reduce the utility’s exposure to potential volatility in the financial performance of its affiliates and protect the utility from potential claims from creditors of its affiliates.
2. Importantly, these direct benefits come without any change in the Commission’s ability to regulate NW Natural, without any change in customer rates, without any change in the level or quality of service, and with shareholders bearing the costs of the Reorganization.

# CONCLUSION

1. NW Natural requests that the Commission approve its proposed Reorganization. The direct benefits resulting from the Reorganization, coupled with the extensive commitments set forth in this Application, ensure that customers will receive net benefits from the Reorganization and that the public interest will be served.

Respectfully submitted this \_\_\_ day of \_\_\_\_\_\_\_, 2017.

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1. This Commission has specifically recognized that current challenges facing utilities may prompt them to “alter their traditional business model, seeking both new opportunities for growth and financial success.” *In the Matter of the Petition of Puget Sound Energy, Inc. for (I) Approval of a Special Contract for Liquefied Nat. Gas Fuel Serv. with Totem Ocean Trailer Express, Inc. & (II) a Declaratory Order Approving the Methodology for Allocating Costs Between Regulated & Non-Regulated Liquefied Nat. Gas Servs.*, Docket No. UG-151663, Order 10 at 6 (Oct. 31, 2016). [↑](#footnote-ref-2)
2. One current subsidiary of NW Natural is NWN Gas Reserves, LLC, which is operated for the benefit of utility customers. [↑](#footnote-ref-3)
3. HoldCo and Merger Sub will be incorporated after NW Natural receives the necessary regulatory approvals for the Reorganization. [↑](#footnote-ref-4)
4. NW Natural does not anticipate that the Reorganization will result in a taxable event, under either Washington state law or the Internal Revenue Code. The Internal Revenue Service (“IRS”) previously recognized events of this nature as tax-free reorganizations. [↑](#footnote-ref-5)
5. RCW 80.12.020(1). [↑](#footnote-ref-6)
6. *See, e.g.*, *In the Matter of the Application of PacifiCorp and Scottish Power PLC for an Order (1) Disclaiming Jurisdiction or, in the Alternative, Authorizing the Acquisition of Control of PacifiCorp by Scottish Power and (2) Affirming Compliance with RCW 80.08.040 for PacifiCorp’s Issuance of Stock in Connection with the Transaction*, Docket No. UE-981627, 2d Supp. Order at 4 (Mar. 16, 1999). [↑](#footnote-ref-7)
7. WAC 480-143-170. [↑](#footnote-ref-8)
8. *See, e.g.*, *In the Matter of the Application of PacifiCorp For an Order Approving Corporate Reorganization to Create a Holding Company, PacifiCorp Holdings, Inc.*, Docket No. UE-010594, Order Approving Corporate Reorganization to Create Holding Company, with Conditions at 3 (Sept. 26, 2001). [↑](#footnote-ref-9)